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United Nations Capital Development Fund

UNCDF business plan 2005-2007*

Investing in the LDCs to achieve the Millennium Development Goals

Summary

This document presents the 2005-2007 business plan and implementation arrangements for the United Nations Capital Development Fund (UNCDF), proposed in accordance with Executive Board decision 2005/5.

The plan is an integral part of the wider United Nations and UNDP efforts in support of the Millennium Development Goals (MDGs). Building on the UNCDF niche and comparative advantages, the plan foresees an expansion of UNCDF investments in and technical support to least developed countries (LDCs) in the areas of local development and microfinance, thus supporting an increased number of LDCs to achieve the MDGs by 2015. The plan outlines the strategies for generating increased business and resources, and translating these into concrete development results. The implementation arrangements spell out how the Fund, as an independent legal entity, intends to strengthen its partnership with UNDP and move closer to UNDP in financial terms. It also notes that any recommendation to adjust the financial arrangements for UNCDF is required to be submitted to the General Assembly for approval.

Elements of a decision

The Executive Board may wish to review the present business plan and implementation arrangements, and provide guidance as to the policy, operational, financial and legal issues described in the document.

* The compilation of data required to present the Executive Board with the most current information has delayed submission of the present document.

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I. Introduction

1. This document presents the 2005-2007 business plan and implementation arrangements for the United Nations Capital Development Fund (UNCDF), proposed in accordance with Executive Board decision 2005/5 on options for a future business model for UNCDF.

2. In its decision 2005/5, the Executive Board chose, from among the options for the future of UNCDF it had requested the Administrator to develop, "to maintain UNCDF as an independent organization focused on reducing poverty and achieving the Millennium Development Goals in the least developed countries".

3. Furthermore, the Board opted for a closer financial relationship between UNCDF and UNDP and requested the UNDP Administrator: "...on the basis of option 3, sub-option 4 of document DP/2005/8, to provide a detailed implementation plan for this option, including budgetary, legal and programming arrangements, for decision at the 2005 annual session of the Executive Board."

4. In selecting this option, many members of the Board from least developed and donor countries voiced their strong interest in seeing UNCDF financially strengthened to fulfil its strategic mandate to invest in the LDCs to achieve the MDGs. The Board also called upon UNDP to assist UNCDF in mobilizing the resources necessary to sustain its support to local development and microfinance.

5. This document responds to and extends beyond the detailed implementation plan requested by the Board. In view of the prerequisites for defining the implementation arrangements, a full business plan for 2005-2007 was developed, establishing the strategy, organizational and financing requirements and implementation arrangements for UNCDF to fulfil the vision articulated by the Board in January 2005.

6. Subject to approval by the Board, the business plan and implementation arrangements will form the basis for UNCDF operations and the UNDP-UNCDF financial arrangement going forward. The annual session of the Executive Board provides an excellent platform to launch the plan and generate awareness of and support for a revitalized UNCDF, making a vital contribution to achieving the MDGs in the LDCs.

II. UNCDF business plan 2005-2007 and implementation arrangements

A. The business plan

Framework for developing the business plan and implementation arrangements

7. The UNCDF business plan 2005-2007 should be seen as an integral part of the wider United Nations and UNDP efforts in support of the MDGs. It has the ambition to:

(a) Position UNCDF squarely at the forefront of the international development agenda as a catalytic agent for investing in development and piloting sustainable approaches that can be leveraged for policy reform and scaled up to make a significant impact on the MDGs in the LDCs.

(b) Ensure that UNCDF can respond more effectively to the demands of its LDC clients and partners, while necessarily prioritizing interventions according to their potential for being scaled up in programmes that mobilize larger domestic and external resources, and which lead to policy and institutional reform and greater MDG impact.

(c) Aspire to further global standards, generate best practices and uphold a reputation for excellence for UNCDF.

(d) Further leverage the original capital assistance mandate given to UNCDF by the General Assembly in 1966, in order to support the achievement of the MDGs in a large number of LDCs.

(e) Capitalize on, and optimize, the established, successful partnership between UNCDF and UNDP to maximize the value that joint UNDP/UNCDF programmes deliver to the LDCs.

(f) Situate UNCDF at the cutting edge in implementing United Nations reform and simplification and harmonization.

8. The business plan takes as its key reference and starting point option 3, sub-option 4 selected by the Board in decision 2005/5. The option was developed into a clear roadmap for UNCDF through a change management process that involved the participation of UNCDF staff and facilitation by UNDP.

9. The UNCDF business plan responds ambitiously to the framework set by recent policy documents that are shaping the international development agenda. Key among these are the United Nations Millennium Project report, *Investing in development: a practical plan to achieve the Millennium Development Goals*, and the report of the Secretary-General, *In larger freedom: towards development, security and human rights for all*. The plan also responds to the Brussels Programme of Action for the LDCs, the report of the United Nations Private Sector Commission, *Unleashing entrepreneurship*, and evolving operational policies on simplification and harmonization.

Analysis of market demand and supply

10. *In larger freedom* and *Investing in development* are united in underlining the need for a greatly increased investment rate, both public and private, to achieve the MDGs – particularly in the LDCs. There are positive signs, too, that momentum is indeed building to increase investment and aid flows. Higher levels of resource commitments and investment call for a commensurate increase in capacities at all levels – especially the local level – to plan, manage and deliver resources effectively. In the words of the Secretary-General: "Many of the poorest countries will need major capacity-building investments to put in place and maintain the necessary infrastructure and to train and employ qualified personnel. The strategy should be anchored in the *practical scaling-up of public investments, capacity-building, domestic resource mobilization and, where needed, official development assistance,"* and "A healthy private sector capable of generating jobs, income and tax revenues over time, [and ensuring] sustainable economic growth... requires *significantly increased investments in human capital and development-oriented infrastructure... and expanded access to financial capital, including microfinance.*"[1] These framework documents reflect the urgent demand for replicable and locally appropriate delivery mechanisms to ensure the scalability of interventions that will be critical to achieving the MDGs.

11. Below, a summary of market demand and supply in relation to 'development-oriented infrastructure' (basic socio-economic infrastructure and services) and financial services in the LDCs – the focus of current UNCDF service lines – provides the basis for asserting the niche of UNCDF. A fuller analysis was developed and is made available separately to the Executive Board.

12. With respect to local development, the lack of access to basic socio-economic infrastructure and services is recognized as a major obstacle to achieving the MDGs, especially in rural areas. Improving access has a direct impact on the MDGs in local communities. It is also recognized as a key condition, along with, inter alia, access to financial services (supported by the second UNCDF service line), for stimulating the

[1] United Nations Secretary-General, *In larger freedom: towards development, security and human rights for all*, paragraphs 34 and 37.

local, pro-poor economic development that is equally essential for achieving the MDGs. An urgent recommendation of the Millennium Project report and the Brussels Programme of Action for the LDCs is to increase investment and technical support in this area. Such support, it is emphasized, needs to be delivered through approaches that are sustainable, that develop capacity and incentives underpinning effectiveness and efficiency, and that mobilize and optimize the contributions of governments, local communities, civil society and the private sector.

13. Much of the basic socio-economic infrastructure and services required to achieve the MDGs – and prioritized in poverty reduction strategies – are precisely those that are most effectively decentralized to local governments to deliver. Critically, there must be scope for 'scaling-up' the approach to reach large numbers of poor people, and, to that end, for boosting local absorptive capacities for effective, efficient use of public and donor funds. However, suppliers have largely ignored the challenges of designing scaleable, institutionally sustainable delivery models in poor, rural areas, often opting for parallel and supposedly more expeditious approaches.

14. In respect of microfinance, lack of access to financial services for the majority of the population is a major roadblock to achieving the MDGs in the LDCs. A key constraint is the shortage of strong microfinance institutions (MFIs). The Consultative Group to Assist the Poorest (CGAP)[2] has concluded that donor funding is often ineffective. "Most donor funds are concentrated in a few countries and on a few strong and/or nearly sustainable MFIs with a track record. Other donors fund MFIs or projects with very limited potential for sustainability, while more promising candidates face funding shortages. This concentration of funding leaves many MFIs off the donor radar screen"[3]. CGAP notes that the principle task of donors is to identify and bet on promising but riskier MFIs, leaving known 'winners' to commercial investors. In doing so, donors need to devote more resources to technical assistance, including time-intensive institutional capacity-building. Other constraints are the lack of an enabling economic, political and legal environment allowing financial services to be delivered on a sustainable basis, and weak or absent supporting infrastructure for the industry.

The niche and comparative advantages of UNCDF

15. To assert the niche UNCDF corporately, and in its two service lines, it is important to identify where UNCDF fits within the range of suppliers responding to the huge, unmet demand for improved access to basic socio-economic and high-quality financial services.

16. The 2004 independent impact assessment summarized the critical niche of UNCDF and its added value in responding effectively to this demand and supporting the attainment of the MDGs in LDCs. "UNCDF programming models in both microfinance and local governance demonstrate a clear and innovative niche... The Fund has contributed to significant results through both its microfinance and local governance programmes in poverty reduction, policy impact, and replication of its projects by donors... It fulfils an important risk-taking, innovation role that other development agencies and LDC governments are interested in expanding and building on... UNCDF's areas of expertise are very much in demand in LDCs... In fact, LDCs are asking for more of UNCDF's services. UNCDF is praised by the majority of its stakeholders as a flexible partner that is active in developing knowledge, effective in implementing projects, and influencing the orientation of the sectors in which it works... Furthermore, assessment of UNCDF's programmes confirmed that UNCDF's mission, programmes and goals are relevant to the achievement of the Millennium Development Goals. Its

[2] CGAP is a consortium of 28 public and private development agencies working together to expand access to financial services for the poor.
[3] CGAP Donor Brief 3 (2002) Water, water everywhere, but not a drop to drink.

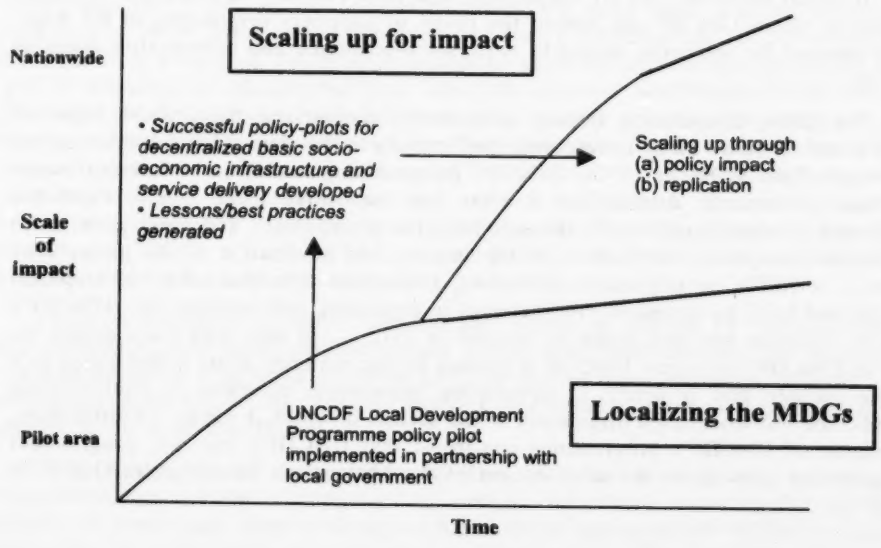
programming supports the Programme of Action for the LDCs for the decade 2001-2010 and responds to the local needs of the countries in which it intervenes."[4]

UNCDF niche in local development

17. The clear niche of UNCDF in local development vis-à-vis other suppliers lies in piloting models for sustainable, decentralized solutions to the delivery of basic socio economic infrastructure and services, particularly in the poorer rural areas where the MDG challenges are typically the greatest (see figure 1). Its effectiveness derives from its small-scale, grant-funded capital investment mandate, its strong technical expertise, and a proven approach – its signature Local Development Programme (LDP). These comparative advantages allow UNCDF to design and implement real-time policy-pilots with local partners, utilizing seed investment funds and technical capacity-building support to improve demand-driven service delivery in poor, rural communities. Demand is expressed through participatory planning systems that seek to ensure a voice for women and other disadvantaged groups in the decision-making process.

18. The approach is designed to generate models that can be scaled up for much wider impact, through replication and policy impact, to reach large numbers of the poor in LDCs. To that end, the pilots are designed to reform the system of central-local government institutional and fiscal relations by working within this system rather than bypassing it. Working in partnership with national and local authorities, the aim is to operationalize principles of good local governance and public expenditure management; to extend good practices and lessons learned elsewhere; and to mobilize the contributions of local communities, the local private sector and civil society, in order to promote more effective service delivery. UNCDF leverages lessons from the policy-pilots to influence national policy decisions on decentralized service delivery which then impact nationally on the public administration system, and to promote broader replication of the approach by governments and/or other donors in other regions of the LDC, or indeed nationwide.

Figure 1: UNCDF niche in scaling-up policy-pilots for decentralized delivery of basic socio-economic infrastructure and services


Scaling up for impact
Nationwide
• Successful policy-pilots for decentralized basic socio-economic infrastructure and service delivery developed
• Lessons/best practices generated
Scaling up through
(a) policy impact
(b) replication
Scale of impact
Pilot area
UNCDF Local Development Programme policy pilot implemented in partnership with local government
Localizing the MDGs
Time

[4] Universalia (2004) Independent impact assessment of UNCDF: Synthesis report, pii, piv, www.uncdf.org/IIA2004.

19. This is a niche in which UNCDF has delivered excellent results, as recognized by the 2004 independent impact assessment. A recent OECD-DAC comparative review of 19 multilateral and bilateral decentralization and local governance support programmes identified UNCDF LDPs as "the only example whereby a programme was successfully institutionalized and replicated nationwide"[5].

20. Local governments in LDCs often remain at the margins of national efforts to implement poverty reduction strategies. The LDP approach is attracting attention in this respect, as it recognizes the comparative advantages of local governments to promote participatory assessments of local demand for infrastructure and services, and to realize allocative and efficiency gains in their provision, effectively "localizing" the MDGs. The LDP approach (based on the multi-sectoral political and fiscal responsibilities of local authorities) has specific advantages – for example, in terms of sustainability and multi-sector coordination – over the other two main approaches pursued by donors and governments, namely the community development approach (based on the priorities and preferences of local populations) and the decentralized sector-development approach (based on national sector policies).

21. The fast-growing interest in and levels of co-financing for UNCDF programmes further attest to the recognized value of the UNCDF approach. Co-financing is forthcoming not only from donors, but, significantly, from LDC governments who see its results and potential for impact. Following successful UNCDF pilots, the governments of at least ten LDCs have replicated the model nationally. Some governments are financing an increasing share of the decentralized investments themselves.

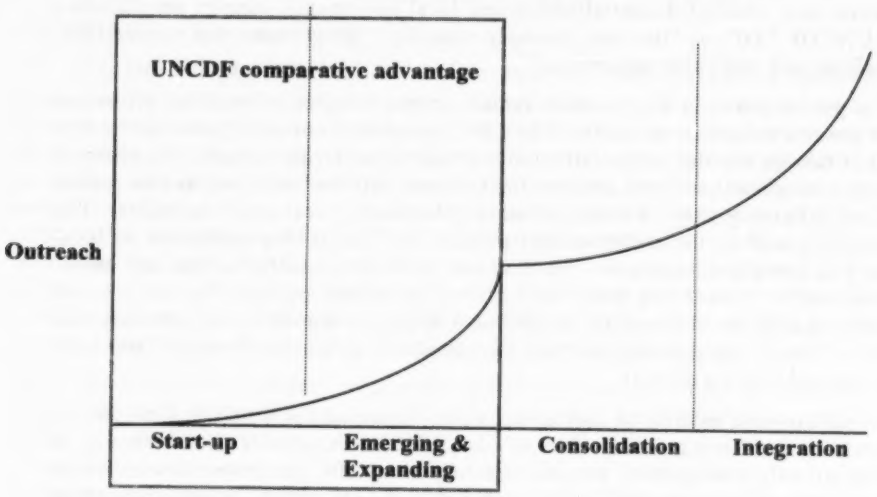
22. UNCDF will continue to develop and refine its niche in response to client demand. For example, capitalizing on the LDP approach, UNCDF has recently embarked on testing strategies to promote local economic development and local environmental governance, and is exploring the potential to leverage information and communications technologies to support local development.

UNCDF niche in building inclusive financial sectors

23. The niche of UNCDF in microfinance relative to demand and other suppliers is in supporting countries in the start-up and emerging phases of microfinance sector development (see figure 2). A majority of these countries are LDCs, including those emerging from conflict or crisis situations. In these phases the objective is to build the institutional capacity and capital base of MFIs so they become fully self-sustaining. UNCDF success in this area is well recognized in both the independent impact assessment and the CGAP review of the UNDP microfinance portfolio, which noted: "The successful model is the MicroStart programme pioneered by UNCDF's microfinance unit... MicroStart's 'hit rate' of successful projects was 69 per cent, which represents strong performance, not only compared to other donors, but also in absolute terms."[6]

[5] OECD/DAC (2004) *Lessons learned on donor support to decentralization and local governance*, pp 25 and 52; http://www.oecd.org/dataoecd/46/60/30395116.pdf.
[6] CGAP review of UNDP microfinance portfolio, p.2

Figure 2. Phases in the development of the microfinance sector



24. A key challenge in the early phases is the creation of an enabling environment for the sector. Policies and regulations, or a lack of coordination among donors, can pose constraints. The UNCDF sector development approach supports governments and stakeholders in building a common vision for the development of the industry in the form of a national policy or strategy, and catalyses investment in MFIs with the potential to serve a large client base on a sustainable basis, as well as in the supporting industry infrastructure.

25. At a later stage, as sound MFIs are created, the maturing microfinance industry becomes self-reliant. A strong microfinance industry operating in a conducive environment can attract deposits and commercial loans for future growth[7], reflecting the experience that where capacity leads, capital follows.

UNCDF comparative advantages

26. The key attributes of UNCDF, highly valued by its partners, are summarized in table 1.

Table 1: Comparative advantages underpinning UNCDF ability to deliver effectively in its niche areas

Comparative advantage	Explanation and significance
Sole United Nations organization investing exclusively in LDCs	Distinct identity as an organization specialized in investing in the LDCs to reach the MDGs, notably in remote, rural areas where large numbers live in poverty.
Risk-taking investment fund with a clear strategic role in achieving the MDGs in the LDCs	UNCDF is a risk-taking investment fund with a high degree of flexibility and efficiency. Working closely with its LDC clients, UNCDF capacity and experience with assuming risk make it a valued partner of LDCs and donors in piloting new approaches for subsequent scaling-up.

[7] More than 50 funds invest in microfinance. Most are social-investment funds operating in a not-for-profit or semi-commercial manner.

Appropriate, flexible instruments: technical assistance and capital funding, using grants and loans	The range and scale of financing instruments and technical assistance that UNCDF offers is unique in the United Nations system and is tailored to its niche of investing in policy-pilots and start-ups. The ability to combine small-scale grant capital assistance with technical support is key to UNCDF local development programme success. The flexible use of grant and soft-loan instruments enables UNCDF to support financial-sector development. UNCDF is the only United Nations organization able to provide loans directly to MFIs, allowing a credit history to be established.
Strong technical capacity with intimate local-level knowledge	UNCDF has strong technical staff capacity (increasingly decentralized to move closer to its clients) with excellent knowledge of local stakeholders in LDCs, and the dynamics between them, critical for "localizing" the MDGs.
Full integration in the UNDP group and national and United Nations planning and programming frameworks	The complementary UNDP-UNCDF partnership permits the United Nations to implement pilots that have local-level investment piloting and upstream policy and replication objectives, leveraging the added value of UNCDF capital investment and technical support combined with UNDP capacity-building, policy advocacy and convening power to feed the lessons of policy-pilots into policy decision-making processes. The relationship with UNDP also provides important efficiency gains and facilitates early entry in post-conflict countries. UNCDF contributes to and aligns with national and United Nations planning and results frameworks, notably PRS and MDG strategies, United Nations development assistance frameworks and country programme action plans.
United Nations neutrality and multilateralism, and absence of a political agenda	Neutrality enables UNCDF to use objective investment criteria in determining the selection of interventions, play a leadership role in developing a shared understanding of sector needs, and – together with UNDP – address sometimes politically sensitive issues to improve the policy environment.
Accountable, results-oriented organization	Track record of regular monitoring and independent evaluation, using a clear SRF. This ensures accountability, lesson- learning, timely interventions to address problems, and good results.

UNCDF vision to 2010: Investing in the LDCs to achieve the MDGs

27. In the next five years, UNCDF will support the LDCs to gear up to achieving the MDGs. Combining its catalytic capital investment mandate with cutting-edge technical support in its recognized areas of expertise – local development and building inclusive financial sectors – UNCDF will expand its activities to respond to demand with the urgency required to achieve the MDGs in LDCs by 2015.

28. The potential to achieve significant, MDG-impacting results will continue to lie in UNCDF working with partners, particularly UNDP, to successfully leverage the lessons and best practices emerging from its policy-pilots in order to influence national policy and promote scaling-up – increased, effective, efficient, economical investment – by other public (government and donors) and private (commercial) actors. UNCDF will thereby support LDCs to establish the conditions and capacity, and mobilize and access the resources necessary to increase significantly the access of their citizens – especially the poor – to financial services and basic socio-economic infrastructure such as clean water, sanitation, rural roads, schools, and health clinics. This will have the double impact of increasing access to the various services underpinning human development and the related education, health and environment aspects (MDGs 2-7), and creating the conditions for the vibrant, sustained, pro-poor economic development vital to the reduction of income-poverty and hunger (MDG 1).

29. All LDCs that meet basic investment criteria will be able to benefit from UNCDF expertise and investment. By 2010, UNCDF will have expanded its support for LDPs to 40 LDCs, and for building inclusive financial sectors to at least 25 LDCs, significantly stepping-up its support to implementing the Millennium Project report's plan to achieve the MDGs and the Brussels Programme of Action for the LDCs. Through programmes carried out by UNCDF with its partners, an estimated 17 million additional women and men will be provided with access to basic socio-economic and/or financial services; many more will benefit indirectly through upscaling. The bulk of resources to fund this expansion will come from non-core contributions to UNCDF programmes, attracted by the track record and high-quality programming of UNCDF and recognition of the added value that the UNCDF strategy brings to achieving the MDGs in the LDCs. UNCDF will develop additional strategies for supporting MDG attainment in LDCs where there is real programme-country demand matched by adequate funding, and where new service lines build upon the comparative advantages of UNCDF.

30. The strategic goals of UNCDF, as reflected in its 2005-2007 SRF (see annex 1) are complementary to the development outcomes being pursued by UNDP, as articulated in the 2004-2007 multi-year funding framework (MYFF), reflecting the complementary operational partnership of the two organizations.

Local development: objectives and strategy to 2010

31. UNCDF will remain a recognized leader in decentralization and local development and will leverage its local-development policy-pilots to have a major impact on the MDGs from a local perspective. By improving the effectiveness and efficiency of infrastructure and service delivery at the local level, UNCDF support will increase access to basic socio-economic infrastructure and services and help create the conditions for vibrant, pro-poor local economic development that benefit women and men equally. In the next five years, UNCDF will increase the benefit of its services for local development to the LDCs and its impact on the MDGs by:

(a) Expanding support to more LDCs, increasing coverage from the current 25 to at least 40 LDCs;

(b) Increasing average investment in LDPs to at least $5 million per project to ensure scalable models and achieve greater local MDG impact in pilot areas, directly benefiting 12 million poor and low-income women and men, and many more indirectly, through scaling-up;

(c) Maximizing the leverage of UNCDF models for scaling-up and policy impact, wherein lies the potential for large-scale impact of UNCDF support on the MDGs;

(d) Strengthening partnerships with major multilateral and bilateral organizations for business development, cost sharing, knowledge sharing and in pursuit of United Nations harmonization, efficiency and effectiveness gains; and

(e) Leveraging increased partner financing: Building on recent steady growth in non-core resource mobilization, secure over time 300 per cent co-financing from partners for future programmes, to optimize the partnership and resources behind UNCDF policy-pilots, and hence their potential for scaling-up and policy impact.

32. The primary clients for LDPs in the LDCs are poor rural communities and their local governments, which request UNCDF support for local development. The LDP pilots are implemented by local authorities and are fully client-owned and operated; they emphasize local participation in planning and implementing programmes. The success and sustainability of the pilots is largely a reflection of the client-orientation of the product.

33. UNCDF aims to help LDCs achieve the local development critical to meeting the MDGs with the following products and services:

(a) *The LDP policy-pilot*, a signature product of UNCDF.

(b) *Scaling-up: policy impact and replication.* LDPs will be leveraged to inform and influence national policy dialogue on decentralization and to promote replication by government and other development partners. When requested, UNCDF will assist in the design of national policy and regulatory/legal frameworks.

(c) *Technical advisory services* for decentralization and local development to UNDP country offices in LDCs.

(d) *Knowledge generation and sharing*: UNCDF documents and shares experiences accumulated by LDPs in South-South fora and with key partners and stakeholders. This contributes to the body of knowledge on decentralization and local development and keeps UNCDF interventions at the cutting edge.

(e) *Innovations building on the LDP model:* UNCDF is developing innovations to promote local, pro-poor economic development involving the local private sector. Other LDPs have a specific emphasis on local environmental governance, drawing on the wide-ranging experience of UNCDF in the Sahel region.

Microfinance: Objectives and strategy to 2010

34. "The great challenge before us is to address the constraints that exclude people from full participation in the financial sector... Together, we can and must build inclusive financial sectors that help people improve their lives."[8]

35. UNCDF will have a direct impact on increasing access to sustainable financial services, and an indirect impact, through stimulating vibrant, pro-poor economic development through increased availability of financial services to low-income households and women in particular, as well as micro- and small enterprises. In the next five years, UNCDF will increase its microfinance services to the LDCs and its impact on the MDGs by:

(a) Expanding its support to at least 25 LDCs to develop the financial infrastructure that will provide financial services to the majority of poor and low-income households and micro and small businesses, benefiting women in particular.

(b) Focusing its investments and activities on supporting the development of microfinance sectors at the start-up or emerging phase.

(c) Tailoring each intervention to meet the specific needs of the country and its level of sector development. UNCDF will identify constraints for retail providers of microfinance (micro level), gaps in the supporting infrastructure (meso level) or policy, legal and regulatory obstacles (macro level) blocking access to financial services.

(d) Partnering with UNDP to support governments, central banks, donors and other key stakeholders in LDCs to establish national strategies, policies and interventions to develop an inclusive financial sector.

(e) Providing capacity-building and capital support to build sustainable national coverage by MFIs, while leveraging other sources of funds, including commercial capital. UNCDF will provide capacity-building and capital support to at least 50 MFIs that will have an active client base of more than 5 million clients by 2010.

(f) Leveraging increased partner financing – securing at least 200 per cent co-financing from partners for future programmes.

[8] United Nations Secretary-General Kofi Annan, announcing 2005 as the International Year of Microcredit.

36. The primary clients of UNCDF microfinance support in the LDCs are poor and low-income people, especially women, who need access to financial services. Other clients include the microfinance industry, central banks and LDC governments, UNDP country offices, donors and other investors.

37. UNCDF aims to help LDCs build inclusive financial sectors critical to achieving the MDGs with the following products and services:

(a) *Investment in MFIs, building potential market leaders and competitive microfinance sectors.* UNCDF invests in a variety of institutions serving poor and low-income clients, capitalizing them and building their institutional capacity. Its signature product, MicroStart, will continue to be a core product for building 'investable' MFIs, including the use of technical service providers that have demonstrated ability to provide sustainable microfinance.

(b) *Investment in building an environment conducive to the development of an inclusive financial sector.* This will include support to the development of enabling legal and regulatory frameworks, capacity-building of central bank staff responsible for supervising microfinance sectors, and investment in supporting industry infrastructure, such as networks and audit capacity.

(c) *National policy, strategy and programme design:* Sector assessments identify constraints and untapped opportunities to be addressed in order to develop inclusive financial sectors. Where needed, UNCDF will assist in the design of a national policy and strategy reflecting a shared vision.

(d) *Knowledge generation and sharing:* UNCDF and the Financing for Development Office of the United Nations Department of Economic and Social Affairs (DESA) are leading a process with global outreach to identify constraints and opportunities for the promotion of inclusive financial sectors. Supported by an inter-agency team with representatives of the World Bank, the International Monetary Fund, the International Labour Organization and the International Fund for Agricultural Development, as well as by input from other financial-sector experts, this research – known as the 'blue book on building inclusive financial sectors' – will serve as a guide for developing action plans at the country level. UNCDF will continue to update this research periodically.

(e) UNCDF will continue to serve as policy advisor to UNDP for microfinance, representing UNDP in CGAP and providing policy support to the Office of the Administrator.

Business development strategy

38. To support the realization of the UNCDF business plan and drive the rapid expansion of UNCDF capacity to respond to LDC demand for its services and increase its geographical coverage of and investment size in LDCs, UNCDF will develop a comprehensive business development strategy in the course of 2005. This integrated strategy will encompass interlinked strategies for partnerships, branding and communications, and resource mobilization, which will enable UNCDF to capitalize on specific business-development opportunities such as those outlined below:

(a) High-profile opportunities that increase awareness of LDC needs, establish UNCDF as a preferred partner to pursue strategies contributing to achievement of the MDGs in the LDCs, and generate financial support for UNCDF for that purpose. Targeted events include the September 2005 Millennium Summit; the 2005 Year of Microcredit, jointly coordinated by UNCDF and DESA; and the 2006 mid-term implementation review of the Brussels Programme of Action. Other fora, including non-traditional fora such as G8 summits and the World Economic Forum, will be assessed for their potential in this regard.

(b) Favourable positioning of UNCDF as a vehicle to implement key aspects of the action plan of the Millennium Project report, *Investing in development*, in the LDCs, as well as the Brussels Programme of Action for the LDCs, will contribute to regional development initiatives such as the New Partnership for Africa's Development, and to formulating practical solutions for implementing poverty reduction strategies and MDG action plans in the LDCs at the local level.

(c) Strong political support for UNCDF from the LDCs and the Group of 77, which can be leveraged to generate fresh funds from traditional and non-traditional donors to finance investments in the LDCs.

(d) Increasing donor interest in co-financing and providing non-core resources to UNCDF local development and microfinance programmes.

(e) Potential for partnering with UNDP to respond to many of the above opportunities, as well as specific strategic partnerships with regional bureaux and regional service centres, the Bureau for Crisis Prevention and Recovery, the Bureau for Development Policy, the Special Unit for South-South Cooperation, and country offices.

39. The UNCDF branding and communications strategy will be in place by mid-2005 to support the new business plan and equip UNCDF to exploit the above opportunities. The objective is to develop branding and communications as a powerful tool for resource mobilization and positioning. The strategy will ensure, first, that UNCDF has a clear image as a United Nations fund for investing in LDCs and is recognized for its added value and contribution to achieving the MDGs. Second, the strategy will facilitate the sharing of knowledge generated through joint UNDP/UNCDF work in local development and building inclusive financial sectors. The follow-up to advocacy activities for the International Year of Microcredit will be integrated into the strategy in 2006.

40. The UNCDF resource mobilization strategy will be designed to ensure that UNCDF has increased access to multi-year, predictable programme resources, both at the global level and for specific programmes at the country level. Recognizing that changing ODA priorities of some key donors have led to a reduced level of core resources and a reduction in burden-sharing among OECD/DAC donors, by mid-2005 UNCDF will have established a global UNCDF trust fund for investing in LDCs. This fund, with a proposed fungible global window and regional and country windows, would, over time, replace current UNCDF core resources as the primary source of predictable, multi-year funding for investing in LDCs. Its service lines will mirror the UNCDF SRF and will be streamlined with UNDP/UNCDF partnerships within the overall MYFF framework.

41. UNDP will support UNCDF in mobilizing resources for the trust fund for investing in LDCs, as well as for specific global and regional initiatives such as the UNCDF-UNDP partnership for localizing the MDGs, and partnerships between UNCDF and UNDP regional bureaux in the sector-development approach to building inclusive financial sectors. UNCDF programmes will be marketed alongside other UNDP programmes such as Capacity 2015, United Nations Volunteers, and local-level public-private partnership initiatives, to offer to donors and the United Nations system at large a focused, integrated set of services available through the UNDP group. Effective headquarters arrangements for joint non-core resource mobilization will be backed up by a substantially strengthened resource mobilization capacity within UNCDF.

42. To support resource mobilization at the country level, UNCDF will make technical experts available to participate in MDG and post-crisis needs assessments in LDCs that request its services. These assessments will permit a detailed analysis of local investment options in areas of UNCDF comparative advantage, and will allow for planning and resource mobilization for possible follow-up programmes. Further, UNCDF is ready to assist governments in LDCs, normally in partnership with UNDP, with specialized technical advice and operational support for the execution of programmes funded by others, notably the multilateral development banks.

43. To facilitate non-core funding for specific UNDP-UNCDF joint programmes at the country level, the incentive system for resource mobilization is being adjusted to ensure that, as of 2005, non-core resource mobilization for UNCDF at the country level is reflected in the performance assessment of the mobilizing country office. UNCDF will continue to use extra-budgetary income generated from non-core resources to finance to a large extent UNCDF staff presence at the country office level.

44. In addition to non-core funding, UNCDF will strive to leverage other donor, government and private sector funding to support programme objectives. This could include funding from UNDP for the capacity-building part of joint programmes; mobilizing co-financing from national partners through budget support for local development; leveraging parallel funding from other donors, development banks and the private sector for investments in MFIs; and scaling-up and replicating LDPs.

45. Cost-recovery mechanisms for technical services provided by UNCDF to UNDP will be revised to ensure a strategic use of the specialized technical advisory capacity of UNCDF to benefit joint UNDP-UNCDF programmes in LDCs. The costs of technical expertise provided by UNCDF will be funded from programmes based on a costing formula agreed upon between UNDP and UNCDF, within the framework of a UNDP-UNCDF country, regional or global partnership. Direct technical services to non-LDCs at the country level will only be provided on an exceptional basis, if the intervention is deemed of strategic importance to the United Nations, or to ensure UNCDF remains at the cutting edge in its two service lines, provided that the intervention is subject to recovery of all costs.

Managing-for-results strategy

46. Achievement of the ambitious UNCDF business plan will hinge not only on generating increased business for UNCDF, but also, critically, on translating programmes and business opportunities into concrete development results. The tools employed by UNCDF to manage for results and provide incentives for organizational effectiveness include:

(a) Self-assessed monitoring of programme and organizational performance according to the UNCDF SRF, reported to the Executive Board through the UNCDF results-oriented annual report (ROAR);

(b) Accountability for results through independent evaluation;

(c) Internal and external audit: a function assumed by UNDP; and

(d) A staff performance assessment system that links individual staff performance to organizational and development effectiveness.

47. UNCDF is moving to put into place an integrated, coherent managing-for-results strategy to support its new business plan in 2005, building on the current range of results-based management systems in the UNDP group and other available best-practice tools. The strategy will include refinements to the evaluation and SRF monitoring and reporting systems, to increase their strategic added value and utility for UNCDF and its external partners.

48. Following an internal review of its evaluation function, UNCDF seeks approval by the Executive Board of revisions to its evaluation policy. The current policy of mandatory, independent mid-term and final evaluations for all programmes over $1 million would be adjusted as follows:

(a) Ensuring alignment with norms and standards for evaluation in the United Nations system[9], the evaluation function of UNCDF would end mandatory final evaluations for all programmes over $1 million, focusing instead on (i) ensuring accountability to key stakeholders by measuring the UNCDF contribution to development

[9] Under development by the United Nations Evaluation Group

effectiveness against the development outcomes in the new SRF, using a set of evaluation tools including outcome evaluations; and (ii) strategic evaluations in response to internal and external stakeholder demand.

(b) Mid-term evaluations, considered valuable to a piloting organization such as UNCDF, would be managed by programme staff.

Should the Executive Board endorse this proposal, a revised evaluation policy for UNCDF will be developed based on these principles.

49. Second, for the period 2005-2007, UNCDF seeks approval of the following innovations to the SRF monitoring and reporting system:

(a) UNCDF performance reporting to the Executive Board will become more strategic, focusing on programme-related outcomes (see annex 1), with evidence from reporting on output results used to analyse UNCDF-specific contributions to these programme-level outcomes. Performance reporting is gender-disaggregated wherever applicable.

(b) UNCDF will adopt and adapt the UNDP balanced-scorecard system and methodology for monitoring and reporting on organizational performance. This will serve to streamline the systems used to assess multilateral organizational effectiveness, using corporate information sources such as the survey of headquarters products and services, the global staff survey, and Atlas.

B. Implementation arrangements

Institutional, governance and management arrangements

50. In line with Executive Board decision 2005/5, UNCDF remains an independent legal entity pursuant to the legislative mandate granted to it by the General Assembly in 1966, retaining its capital investment mandate and other comparative advantages as outlined above. In response to the call for further United Nations consolidation, UNCDF will move much closer to UNDP financially, in accordance with the programme, budgetary and legal arrangements outlined below.

51. The UNDP Administrator is the Managing Director of UNCDF, and reports on UNCDF to the UNDP/UNFPA Executive Board. At the country level, UNCDF is represented by the UNDP resident representative, or as otherwise determined under the new arrangements for the management of the United Nations system at the country level outlined in the Secretary-General's United Nations reform plans. The UNCDF Executive Secretary is responsible for the day-to-day management of the organization.

52. UNCDF will actively engage with United Nations-system management and programming arrangements through the resident coordinator system at the country level, and with the United Nations Development Group at headquarters.

Organizational structure and staffing arrangements

53. Based on the vision articulated in the business plan, UNCDF is realigning its organizational structure along the following lines:

(a) Expansion of its active presence in LDCs, in line with the expected upward trend in the number of LDCs with UNCDF programming.

(b) Increased decentralization to the regional and country levels to ensure an even stronger client focus, with UNCDF staff co-located with UNDP within country offices and regional centres.

(c) Lean headquarters structure, limited to what is required for strategic management and overall policy setting; business development (external communication, strategic partnerships and resource mobilization); programme, portfolio and knowledge management; and overall efficiency, financial integrity and accountability for results.

(d) Strong, well-defined partnership with UNDP, enabling UNDP and UNCDF to systematically exploit opportunities for enhanced efficiency and effectiveness within the United Nations system in line with the broader simplification and harmonization agenda and process of United Nations reform.

(d) Need to ensure financial viability of the organization, with a securely-funded structure flexible enough to be adjusted and expanded to support the expected growth in UNCDF interventions and resource base.

Details of the organizational structure and staffing arrangements will be made available separately to the Executive Board.

Budgetary arrangements

54. The UNCDF business plan reflects its programmatic alignment with the UNDP MYFF 2004-2007, specifically service lines 1.3 (local poverty initiatives, including microfinance), 1.5 (private sector development) and 2.6 (decentralization, local governance and urban/rural development). This enables UNDP and UNCDF to actively encourage and promote joint UNDP-UNCDF programming at the country, regional and global levels. Hence, a direct link can be established between the service lines of the MYFF and funding allocations for UNCDF within the UNDP budgetary and programming arrangements.

55. In line with the call for further United Nations consolidation and in response to Executive Board decision 2005/05, the biennium budget of UNCDF will be mainstreamed into the UNDP biennium budget for 2006-2007 onwards. Since the core funding situation of UNDP, though improving, is not yet at an optimum level, the funding provided for under the 2006-2007 biennium budget will be limited to cover the administrative costs of UNCDF, estimated at about $5 million per year. It is expected that donors will recognize this additional UNDP commitment by ensuring a commensurate increase in funding for UNDP. The Executive Board may wish to consider the possibility for UNDP to increase direct funding to UNCDF beyond this level, whether for programme or administrative support, or both, as part of the preparation of the 2008-2009 biennium budget and the 2008-2011 programming arrangements.

56. Appropriate modalities are being devised to ensure that UNCDF can easily access potential funding for its operations provided as part of the UNDP biennium budget. Once finalized, the arrangement should also ensure straightforward, delegated approval mechanisms for these resources to permit efficient operations as well as clear accountability lines.

57. To complement UNDP funding for administrative costs, UNCDF will fund additional programme support posts, notably at the regional level, out of its programme resources, striving, where applicable, for a cost-sharing formula with UNDP within the context of the regional cooperation frameworks.

58. Funding for country-level presence and any additional management and administrative posts to support non-core programme implementation will come from extra-budgetary resources. These resources will be generated by charging a fixed percentage, aligned with the UNDP cost-recovery policy, on all core and non-core programme resources, thus ensuring full proportionality between core and non-core resources. In addition, extra budgetary income generated through services as an executing or implementing agency for UNDP or others will be credited to this account.

59. UNCDF will use the opportunity of its excellent partnership with UNDP to advance simplification and harmonization and increase efficiency gains. The appropriate format for cost-recovery for services provided by UNDP to UNCDF at both headquarters and country levels is under preparation.

Programming arrangements

60. No UNDP programming resources will be specifically earmarked under the 2004-2007 programming arrangements.

61. Key risks associated with the above programme arrangements are that programming resources for UNCDF (i) remain at the current level, insufficient to invest in projected new LDC programme countries, and/or (ii) are not received in a timely manner, or remain too unpredictable, to be used effectively as a basis for UNCDF multi-year programming.

Legal arrangements

62. The business plan maintains UNCDF as an independent United Nations organization and reinforces the mandate given to the Fund by the General Assembly in 1966. The proposed budgetary arrangements for the 2006-2007 biennium are grounded in General Assembly resolution 3249 (XXIX) of 1974, which emphasised that "the United Nations Capital Development Fund should be enabled to discharge effectively its responsibilities regarding the elaboration and execution of the projects, through appropriate administrative support". It also reaffirmed "the provision of article IV, paragraph 2, of General Assembly resolution 2186 (XXI) regarding expenses for administrative activities of the United Nations Capital Development Fund", i.e., that assessed contributions should cover the administrative expenses, and, "as an interim measure", called upon "the Administrator of the United Nations Development Programme to bear such costs from the administrative budget of the Programme". Considering the above, it would appear that any recommendation of the Executive Board to adjust the financial arrangements for administrative and operational support to UNCDF is required to be submitted to the General Assembly for approval.

63. In view of its status as an independent United Nations organization with its own income streams, UNCDF will remain a separate financial entity. Further, the Fund will maintain its separate annex to the UNDP financial regulations and rules, to be updated before the end of 2005 to reflect elements specific to the capital assistance mandate of UNCDF, notably in terms of its capacity to grant loans.

C. Budget forecast (2006-2007)

64. The financial framework for 2006-2007 is based on the following assumptions:

(a) Rapid growth in predictable, multi-year programme resources, also used as a basis for mobilizing non-core resources;

(b) Proportionality: core resources will not be used to subsidize management of non-core resources; and

(c) The UNCDF administrative budget for 2006-2007 will be mainstreamed into the UNDP biennium budget.

65. The administrative costs of UNCDF to be funded through the UNDP biennium budget are estimated to be about $5 million per year for 2006-2007. Further, for UNCDF to be able to fulfil its mandate, it will need a relatively secure volume of predictable multi-year programme resources in the order of $18 million per year, to be provided either as core or as multi-year allocation under the global window of the trust fund for investing in LDCs. Country or regional-level non-core resources, provided either for country-specific programmes or through the country/regional window of the trust fund, are expected to grow rapidly as part of the business development strategy, reaching $37 million in 2007 and $55 million in 2009. The total amount of funding – including miscellaneous income – needed for administrative costs, technical expertise and investment purposes, would therefore be around $49 million in 2006 and $63 million in 2007.

Table 2: Tentative UNCDF resource plan (2006-2007)

Income per year (in millions of dollars)	2006	2007	Total
Through UNDP			
Funding through biennium budget	5.0	5.0	10.0
Through UNCDF			
Core and global window of LDCs trust fund	18.0	18.5	36.5
Non-core & regional/country windows of LDCs trust fund	24.0	37.0	61.0
Technical advisory services/Implementing agency fees	1.0	1.5	2.5
Interest	0.5	0.5	1.0
Total	49.0	63.0	110.0
Expenditures per year (in millions of dollars)	**2006**	**2007**	**Total**
Administrative costs	5.0	5.0	10.0
Core and global window of LDCs trust fund	18.0	18.5	36.5
Non-core & regional/country windows of LDCs trust fund	23.5.0	35.0	58.5.0
Posts funded from miscellaneous income (HQ/regional)	1.0	1.2	2.2
Total	47.5	59.7	107.2

Annex 1: UNCDF 2005-2007

The full UNCDF 2005-2007 will be made available as a separate document to the Executive Board. Below are the programme-level outcomes that will be reported on in the ROAR.

UNCDF goal: Achievement of the Millennium Development Goals in the LDCs

Sub-goal 1: To increase sustainable access of the poor to basic infrastructure, public services

Core result 1: **Pilots for decentralized public expenditure management (PEM) and basic socio-economic infrastructure and service delivery (ISD) successfully implemented**

(a) Effective, participatory assessment of demand for ISD by UNCDF-supported local governments
(b) Increased expenditure on ISD effectively, equitably and transparently managed by UNCDF-supported local governments
(c) Increased and more effective supply and maintenance of local basic socio-economic infrastructure and services by UNCDF-supported local governments, service providers and local communities
(d) Sustainable management of the local natural resource base ensured by UNCDF-supported local governments
(e) Enabling environment for local economic development established by UNCDF-supported local governments

Core result 2: **Pilot models and lessons leveraged for policy impact and replication**

(f) Government amendments to the policy/legal/regulatory framework for decentralized PEM and ISD reflect lessons from UNCDF pilots
(g) UNCDF-piloted models for decentralized PEM and ISD scaled up through replication by other funding agencies and/or the government's own budgetary resources

Sub-goal 2: To increase sustainable access of low income households to quality financial services

Core result 1: **Sustainable, retail intermediaries providing a range of financial services to low-income households, established**

(a) Increased outreach of UNCDF-supported financial intermediaries to low-income households
(b) Increased breadth and depth of services provided by UNCDF-supported financial intermediaries to low-income households
(c) Increased sustainability and efficiency of UNCDF-supported financial intermediaries serving low-income households

Core result 2: **Supporting industry infrastructure for the delivery of financial services to low-income households developed**

(d) Local financial sector supporting infrastructure in place
(e) Increased visibility and transparency of UNCDF-supported institutions

Core result 3: **Enabling environment for building inclusive financial sectors fostered**

(f) Increased capacity of government to support conducive policy environment for an inclusive financial sector
(g) Increased capacity of regulatory and supervisory authorities to develop conducive legal framework for an inclusive financial sector
(h) Nationally-owned government and donor strategies exist in support of building inclusive financial sectors

Sub-goal 3 : To strengthen organizational performance

UNCDF will adopt and adapt the UNDP balanced scorecard for monitoring organizational performance. Specific outcomes (to be defined) will fall under the following – preliminary – dimensions:

(a) Stakeholder perception
(b) Organizational efficiency
(c) Learning and growth
(d) Financial resources
(e) Accountability for results
(f) Partnerships

Annex 2: Preliminary list of UNCDF investments in LDCs (2005-2010)

The list below is preliminary only. Investments will be made subject to programme-country demand, matched by adequate funding, and fulfillment of basic investment criteria.

Countries of operation	Present portfolio		Projected portfolio 2005-2007		Projected portfolio 2008-2010	
	Local development	Microfinance	Local development	Microfinance	Local development	Microfinance
Asia						
Afghanistan				x	x	x
Bangladesh	x		x		x	
Bhutan	x		x		x	x
Cambodia	x		x		x	x
Laos	x		x		x	x
Nepal	x		x		x	x
Timor-Leste	x		x	x	x	x
Vietnam	x		x		x	
East and Southern Africa						
Angola		x		x	x	x
Burundi	x	x	x	x	x	x
DR Congo		x	x	x	x	x
Eritrea	x		x		x	
Ethiopia	x		x		x	
Lesotho					x	
Madagascar			x	x	x	x
Malawi	x	x	x	x	x	x
Mozambique	x		x	x	x	x
Uganda	x		x		x	
Zambia			x		x	
Tanzania	x		x	x	x	x
Rwanda	x		x		x	x
West and Central Africa						
Chad					x	x
Benin	x	x	x	x	x	x
Burkina Faso	x	x	x	x	x	x
Niger	x		x		x	
Togo		x		x	x	x
Gambia					x	x
Mali	x		x		x	
Mauritania	x		x		x	
Senegal	x	x	x	x	x	x
Central Africa Republic						x
Guinea	x	x	x	x	x	x
Guinea-Bissau	x	x	x	x	x	x
Liberia		x	x	x	x	x
Sierra Leone		x	x	x	x	x
Arab States						
Djibouti					x	x
Palestinian Territories				x		x
Somalia					x	x
Sudan			x	x	x	x
Yemen	x	x	x	x	x	x
Latin America						
Haiti	x	x	x	x	x	x
Nicaragua	x		x		x	
Total countries by service line	**26**	**14**	**32**	**21**	**40**	**31**
Total countries of operation	**31**		**36**		**42**	

Note: Countries are grouped according to UNDP regional clusters